Supreme Court, U.S.
FILED
NOV 30 2009
OFFICE OF THE CLERK

No. 09-388

IN THE

Supreme Court of the United States

S&D TRADING ACADEMY, LLC, AND
S&D GLOBAL TRADING, INC.,

Petitioners,

v.

AAFIS, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN OPPOSITION

BEN C. BROOCKS
JACKSON WALKER L.L.P.
100 Congress Avenue
Suite 1100
Austin, Texas 78701
Telephone: (512) 236-2000
Fax: (512) 236-2002

Attorney for Respondent

226621

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

QUESTIONS PRESENTED

1. Whether the activities of the Petitioners through their two (2) owners who instructed 28 Chinese securities day traders in, *inter alia*, (a) which securities to purchase and sell (both by specific stocks and by categories), (b) the timing of such purchases and sales, (c) the markets into which such purchases and sales should be made, and (d) trading strategies to maximize day trading profits, and where Petitioners were to be compensated at a rate of one dollar ($1.00) per 1000 shares traded and a percentage of the traders' profits (herein called the "Petitioners' Activities"), constitutes rendering services as "investment advisers" under applicable Texas state and federal statutes, and if so, whether a specific state and federal exemption applies, which exempts "teachers" from registration when any investment advice they may render is solely incidental to the practice of their teaching profession.

2. Whether the Petitioners' Activities constitutes rendering services as a "dealer" under the Texas Securities Act, as amended, requiring registration under that act.

3. Whether the Petitioners' Activities constitutes rendering services as a "broker" under the Securities Exchange Act of 1934, as amended, requiring registration under that act.

PARTIES TO THE PROCEEDINGS AND RULE 29.6 STATEMENT

There are no parties to the proceedings other than those listed in the caption.

Respondent AAFIS, Inc. is a privately owned corporation.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
PARTIES TO THE PROCEEDINGS AND RULE 29.6 STATEMENT	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	v
STATUTORY PROVISIONS INVOLVED	1
STATEMENT OF THE CASE	2
I. Relevant Background Facts	2
II. Course Of Proceedings And Disposition In The District Court And Fifth Circuit	8
REASONS FOR DENYING THE PETITION	11
I. The Rule Of Statutory Construction Cited By Petitioners By Its Own Terms Is Inapplicable	11
II. Even If The Texas State "Teacher" Exemption Were Available Petitioners Would Be Afforded No Relief	17

Contents

Page

A. All Petitioners' Claims Fail As A Matter Of Law Because If There Is An Exemption For TSA Investment Adviser Registration, Then Petitioners Were Required To Register Under The IAA And Failed To Do So. 17

B. Additionally, All Petitioners' Claims Fail As A Matter Of Law Because They Were Required To Register As "Dealers" Under The TSA And Failed To Do So. 19

C. Additionally, All Petitioners' Claims Fail As A Matter Of Law Because They Were Required To Register As "Brokers" Under The Exchange Act And Failed To Do So. 21

CONCLUSION 24

TABLE OF CITED AUTHORITIES

Page

FEDERAL CASES

Akin v. Q-L Invs., Inc.,
959 F.2d 521 (5th Cir. 1992) 13

Allaire Corp. v. Okumus,
433 F.3d 248 (2d Cir. 2006) 15

Cornhusker Energy Lexington, LLC v. Prospect Street Ventures,
No. 8:04-CV-586, 2006 WL 2620985
(D. Neb. Sep. 12, 2006) 22

Massachusetts Fin. Servs, Inc. v. SIPC,
411 F. Supp. 411 (D. Mass.), *aff'd*, 545 F.2d 754
(1st Cir. 1976) 21

S&D Trading Academy, LLC v. AAFIS, Inc.,
Nos. 08-40711, 08-40776, 2009 WL 1885881
(5th Cir. 2009) ..... *passim*

SEC v. George,
426 F.3d 786 (6th Cir. 2005) 22

SEC v. Martino,
255 F. Supp. 2d 268 (S.D.N.Y. 2003) 22

SEC v. Margolin,
No. 92-Civ-6307, 1992 WL 279735
(S.D.N.Y. Sep. 30, 1992) 22

Page

SEC v. Montana,
464 F. Supp. 2d 772 (S.D. Ind. 2006) 21

Stanley v. Trinchard,
500 F.3d 411 (5th Cir. 2007) 10

STATE CASES

Bingham v. State,
913 S.W.2d 208 (Tex. Ct. Crim. App. 1995) ... 12

Breeding v. Anderson,
254 S.W.2d 377 (Tex. 1953) 20

Guitar Holding Co., L.P. v. Hudspeth County Underground Water Conservation Dist. No. 1,
263 S.W.3d 910 (Tex. 2008) 11

Marks v. St. Luke's Episcopal Hosp.,
No. 07-0783 2009 WL 2667801
(Tex. Aug. 29, 2009) 11

Sterling Trust Co. v. Adderley,
168 S.W.3d 835 (Tex. 2005) 13

Cited Authorities

Page

FEDERAL STATUTES

15 U.S.C. § 78c(a)(4) 21

15 U.S.C. § 78c(a)(4)(A) 2

15 U.S.C. § 78o(a)(1) 21

15 U.S.C. § 78cc 8, 21

15 U.S.C. § 80b-1 *et seq* ..... *passim*

STATE STATUTES

Tex. Rev. Civ. Stat. Ann., arts. 581-1 *et seq.* . *passim*

Tex. Gov't Code § 311.001 *et seq.* ..... *passim*

FEDERAL ADMINISTRATIVE DECISIONS

Joseph P. Canouse, Esq., SEC No-Action Letter, 1977 WL 10657 (July 15, 1977) 16

DJZ Associates, SEC No-Action Letter, 1975 WL 9167 (Sept. 26, 1975) 15

First Global, Inc., SEC No-Action Letter, 2001 WL 499080 (May 7, 2001) 23

GlobalTec Solutions, LLP, SEC No-Action Letter, 2005 WL 3695276 (Dec. 28, 2005) 22

Cited Authorities

Page

Herbruck, Alder & Co., SEC No-Action Letter, 2002 WL 1290291 (June 4, 2002) 22

J. H. Rodgas, Jr., SEC No-Action Letter, 1974 WL 10941 (Sept. 7, 1974) 15, 16

Walter H. Shapiro, SEC No-Action Letter, 1978 WL 11703 (July 26, 1978) 15

David A. Umstead, SEC No-Action Letter, 1976 WL 12176 (Aug. 13, 1976) 16

John R. Wirthlin, SEC No-Action Letter, 1999 WL 34898 (Jan. 19, 1999) 23, 24

MISCELLANEOUS

Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before a Subcomm. of the H. Comm. on Interstate and Foreign Commerce, 76th Cong. 90 (1940) (Statement of James White, representing Scudder, Stevens & Clark, Boston, Mass.) 14

STATUTORY PROVISIONS INVOLVED

Petitioners have set forth the relevant text of the statutes dealing with the definition of "investment adviser" and the associated "teacher" exemption, set forth in Texas Securities Act ("TSA"), TEX. REV. CIV. STAT., art. 581-4(N), and the Investment Advisers Act of 1940 ("IAA"), 15 U.S.C. § 80b-2(a)(11).

The TSA defines dealer as follows:

> The term "dealer" shall include every person or company other than an agent, who engages in this state, either for all or part of his or its time, directly or through an agent, in selling, offering for sale or delivery or soliciting subscriptions to or orders for, or undertaking to dispose of, or to invite offers for any security or securities and every person or company who deals in any other manner in any securities within this state.

TSA art. 581-4(C). The definition of the terms "sell" and "offer for sale" and derivatives thereof, is lengthy and may be found at TSA art. 581-4(E).

The Securities Exchange Act of 1934, as amended, defines a broker as follows:

> "(4) *Broker. (A) In General.* The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others."

Section 3(a)(4)(A) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), 15 U.S.C. § 78c(a)(4)(A).

STATEMENT OF THE CASE

I. Relevant Background Facts

D. J. Cleary ("Cleary") and Robert Compher ("Compher") were stock traders who "day traded" securities. They reside and do business in Texas. Cleary was approached about providing some training in day-trading securities to 28 Chinese nationals who were responsible for investing and trading the funds of Respondent AAFIS, Inc. ("AAFIS" or "Respondent"). Cleary, in turn, recruited Compher to assist him. Later, Cleary and Compher formed Petitioners S&D Trading Academy, LLC and S&D Global Trading Inc. (collectively "S&D" or "Petitioners") to perform these services. According to S&D, shortly after reaching a verbal agreement with AAFIS, Cleary and Compher began traveling from Texas to China to perform under the agreement, and traders from China also visited the United States to receive training.

These traders came to Houston, Texas, generally in groups of five or six, with each group staying a few months. In total, S&D performed training on a continuous basis for approximately 16 months. In the district court S&D claimed to have spent in excess of 422 collective "person weeks" of "training" to the 28 traders in Houston and an additional 17 collective "person weeks" in China. Thus, the activities were systematic and performed over a prolonged period of time.

While in Houston, all traders stayed in an apartment furnished with tables, multiple computers and an internet connection. The apartment was also where the vast majority of S&D's training occurred. Thus, the activities of S&D were not undertaken at an educational facility.

Petitioners refer to a portion of the Fifth Circuit opinion to characterize their services as "monitoring the live, online trading activities" of the Chinese traders while also trading on their own accounts, but neglect to reference the expansion of this activity by the Fifth Circuit in footnote 1 to the Fifth Circuit opinion.[1] Furthermore, Petitioners distort the undisputed record in the district court that the Petitioners repeatedly and regularly, among other things, would: (1) recommend both specific stocks and categories of stocks to be bought and sold by the Chinese traders each day; (2) recommend specific stocks for purchase and sale at specific times; (3) recommend when to buy and sell

[1] *S&D Trading Academy, LLC v. AAFIS, Inc.*, Nos. 08-40711, 08-40776, 2009 WL 1885881, *1 (5th Cir. 2009):

> "AAFIS submits that during the trading hours, Cleary and Compher would have the traders who were not sitting at computers beside them tell them when the traders 'got into a trade' so that Cleary and Compher could review the trade and give feedback regarding the transaction. The traders sitting beside Cleary and Compher on any given day received more intense instruction. AAFIS explains that Cleary and Compher would watch these traders more closely and would provide advice prior to the traders entering into a particular trade. These traders could also see the trades Cleary and Compher made.

stocks, i.e., the timing of transactions; (4) set stop losses for each of the traders, i.e., the point in time when each trader was required to stop trading and exit the market; (5) monitor each trader's buying and selling activities and give instructions as to which transactions to execute and when to enter and exit specific transactions; (6) conduct and announce market research to recommend and facilitate purchases and sales of stocks; (7) identify specific buyers and sellers of securities from whom the traders should buy and sell; (8) select markets into which sales and purchases could be directed by the Chinese traders; and (9) teach specific trading strategies, including verifying and predicting when New York Stock Exchange specialists were themselves buying and selling stocks so as to engage in purchases and sales in relation thereto. Without limiting the breadth of the undisputed evidence submitted below, the following quotes from the depositions of Compher and Cleary submitted as part of the record in this case indicate the level of detailed trading advice and control being exercised by Petitioners:

> A: [I]t was a little more intense type of training. You know, I could—I could mentor them a little more closely, and I could verify, you know, everything that was going on, and I could see right away what they were watching, maybe even help them—'I wouldn't even enter that trade. I see what you're looking at. I wouldn't even do that.' It wasn't—you know, they would almost tell—you know, we would work before they got into trades.

Respondent's Brief in the Fifth Circuit ("Resp. Br.") at 20-21 (quoting Compher).

> A: Like I told you, it was much more interactive. I could see what they—what stocks they were pulling up, what stocks they were studying, and I could, you know, talk—talk them through, you know, even before—you know, 'I wouldn't take that trade. I wouldn't even enter that trade. I don't like it. I like this. Here is what I would be looking for,' et cetera, et cetera. So it was more intense. As well, they could see my trades and what I was doing, whereas somebody across the table couldn't see the trades I was making.

Id. at 21 (quoting Compher).

> Q. So D.J. [Cleary] would mentor one person and you would mentor essentially one person. . . .
>
> A: As I mentioned, when those two people would enter a trade, they—they would call out the trade and say, you know, 'I'm in this.' Or they might—before that, they might say, 'Hey, I'm looking at XYZ. What do you think D.J.,' or, 'What do you think Rob?' It was a—a very small room. We were right on top of each other, and I always considered it basically one-on-one mentoring. . . .

Id. at 21 (quoting Compher).

> A: There might be a time—we both had input in her [i.e. one of the traders] trades. There might be a time where D.J. would talk to her

> for a trade, and then her next trade I might take over and tell her what I thought was right or wrong about that trade. So it was getting trained by two people. Essentially D.J. and I were training everybody.

Id. at 21-22 (quoting Compher).

> A: But we were working with everybody in that room. Every time everybody in that room made a trade, we knew about it, and we were helping them through that trade. Because somebody had their back to me, they could still hear me say, 'I wouldn't do this,' or, 'I wouldn't do that,' or et cetera, et cetera, and they were as close as you and I are.

Id. at 22 (quoting Compher).

Petitioners asserted they reached a "verbal agreement" for a roughly three-and-one-half year arrangement with AAFIS in which they were to receive: (i) "base compensation" of $1.00 per thousand shares traded by each trader they trained during a "six month probationary period" and "for up to 36 months thereafter," and (ii) "bonus compensation" calculated according to the net profits generated by each trader they trained "in months 12, 24, and 36." Petitioners did not dispute in either the district court or the Fifth Circuit, that such compensation was "transaction-based compensation."[2] Petitioners contend in this Court,

[2] For example, in response to AAFIS' April 30, 2008 Motion for Summary Judgment in the district court, Petitioners did not dispute the receipt of transaction-based compensation, but

(Cont'd)

however, without explanation or argument, that they did not receive any transaction-based compensation. Receiving compensation based on the number of transactions and the profitability of the transaction, however, is the type of compensation received by brokers and investment advisers.

While this activity was on-going, the parties unsuccessfully attempted to reduce their verbal agreement to writing. Having failed to reach a definitive agreement, AAFIS terminated the arrangement with Petitioners, effective October 2006, and Petitioners filed suit. It is undisputed that Petitioners were substantially paid for all the work they performed prior to the termination of the agreement.

(Cont'd)

argued that registration was not required even though they received transaction-based compensation. Similarly, although one section of Petitioners' brief in the Fifth Circuit was headed "Plaintiffs received no transaction-related compensation" (Petitioners' Brief in the Fifth Circuit ("Pet. Br.") at 19), the only substantive argument in that section was that the receipt of transaction-based compensation does not necessarily require registration as a broker under the Exchange Act:

> "The receipt of transaction-related compensation, without evidence of other securities-based activities that fall within the definition of a broker or dealer, does not require registration. The SEC has made clear that the receipt of transaction-related compensation is merely one factor to consider in determining whether registration is required."

Pet. Br. at 20. *See also* Petitioner's Reply Brief in the Fifth Circuit at 21-25.

II. Course Of Proceedings And Disposition In The District Court And Fifth Circuit

Following a partial summary judgment on most of their claims, and subsequent pleading amendments, as it was undisputed that neither Cleary, Compher, nor either Petitioner held any state or federal registrations or licenses, AAFIS filed a motion for summary judgment on all Petitioners' remaining claims, based in part on the fact that the undisputed underlying conduct of Petitioners required them to register as: (i) "brokers" under the Exchange Act; (ii) "investment advisers" under the IAA, 15 U.S.C. § 80b-1 *et seq.*; (iii) "dealers" under the TSA art. 581-1 *et seq.*; and (iv) state "investment advisers" under the TSA. Both the Exchange Act, 15 U.S.C. § 78cc, and the IAA, 15 U.S.C. § 80b-15(b), forbid recovery of compensation because of a failure to register when required. TSA art. 581-12, like its federal counterpart, forbids "dealers" and "investment advisers" from conducting business without first registering, and TSA art. 581-33(K) renders unenforceable any agreements pursuant to which fees and commissions are sought by an unlicensed person who is required to be licensed. It was undisputed that, should any of these four statutory provisions apply, AAFIS would be entitled to judgment as a matter of law. Further, the Petitioners' underlying conduct was undisputed.

In response to AAFIS' claims that Petitioners were acting as unregistered brokers under federal law, Petitioners simply argued that the services referenced did not constitute "engaging in the business of effecting transactions in securities for the account of others," and

as such registration as a "broker" under the Exchange Act was not required.

Petitioners did not address AAFIS' argument that Petitioners' conduct was that of a "dealer" under the TSA.

Similarly, S&D did not in either the district court or the Fifth Circuit dispute that they were performing the services of an "investment adviser" under both the IAA and the TSA, but claimed entitlement to an exemption from registration. As to the TSA, Petitioners relied on an exemption from investment adviser registration for a teacher, "whose performance of the services [of a teacher are] . . . solely incidental to the practice of the person's profession." TSA art. 581 4(N)(2).

With respect to the IAA, Petitioners relied on 15 U.S.C. § 80b-3a(a), which exempts from federal registration any investment adviser who had less than $25,000,000 in assets under his or its management at the time the services were rendered.[3] This exemption applies, however, only to an adviser who is otherwise regulated by the state in which the adviser maintains its principal office and place of business. As AAFIS pointed out and explains hereafter, this exemption from federal registration was inapplicable if Petitioners were correct that they were exempt from regulation in Texas.

On June 3, 2008, the district court entered an order granting AAFIS' motion for summary judgment.

---

[3] *See* Petitioners' Response in Opposition to AAFIS' April 30, 2008 Motion for Summary Judgment in the district court at 3-4.

Petitioners incorrectly state that the district court granted summary judgment "solely" on S&D's failure to register in Texas as state "investment advisers." The district court actually held that "at the very least" Petitioners were required to be registered as "investment advisers" under the TSA and failed to do so, and that this failure barred all their claims as a matter of law. The district court thus rejected Petitioner's claimed "teacher" exemption.

On July 1, 2009, the Fifth Circuit upheld the district court's dismissal for failure to register as a state investment adviser under the TSA, thus also rejecting the claimed "teacher" exemption. In so doing, the Fifth Circuit held that it need not consider AAFIS' other grounds for upholding the summary judgment (*S&D Trading Acad.*, 2009 WL 1885881 at *7), which it could have considered since summary judgment may be affirmed on any legal ground raised below, even if it was not the basis for the district court's decision. *Stanley v. Trinchard*, 500 F.3d 411, 428 (5th Cir. 2007).

REASONS FOR DENYING THE PETITION

I. The Rule Of Statutory Construction Cited By Petitioners By Its Own Terms Is Inapplicable

Petitioners assert that Tex. Gov't Code § 311.011 (hereinafter referred to as "TGC"), is a mandated rule of construction which must apply to the interpretation of the Texas Securities Act (heretofore defined as the "TSA").[4] This is incorrect. Section 311.011 of the TGC is part of the larger act referred to as the "Code Construction Act" (TGC § 311.001 *et seq.*). The Texas Code Construction Act, by its terms applies to "each code enacted by the 60th or a subsequent legislature as part of the state's continuing statutory revision program . . ." TGC § 311.002. The TSA, however, is not embodied in any particular "code" and therefore neither the Texas Code Construction Act in general, nor § 311.011 in particular, are applicable in the construction of any provision of the TSA. Indeed, the cases cited by Petitioners on this point involve the interpretation of a "code provision." *See, e.g., Guitar Holding Co., L.P. v. Hudspeth County Underground Water Conservation Dist. No. 1*, 263 S.W.3d 910, 925 (Tex. 2008) (interpreting the Texas Water Code); and *Marks v. St. Luke's Episcopal Hosp.*, No. 07-0783 2009 WL 2667801 (Tex. Aug. 29, 2009) (interpreting Chapter 74 of the Texas Civil Practice and Remedies Code).

Even if the Texas Code Construction Act did apply, the application of all of its provisions would afford no

---

[4] It is worth noting that Petitioners' argument regarding the applicability of TGC § 311.011 was not raised in the district court and was raised in the Fifth Circuit only in the Reply Brief.

relief to the Petitioners. First, TGC § 311.003 states that the rules set forth in the Texas Code Construction Act are not exclusive but rather a non-exclusive guide meant to assist in achieving an orderly and proper construction of applicable codes. Furthermore, § 311.011(a) itself requires that words and phrases be read "in context." Indeed, *Bingham v. State*, 913 S.W.2d 208, 210 (Tex. Ct. Crim. App. 1995) states that what is crucial is not a common definition of a term, but its common definition in the particular context: "[w]hile common acceptation of an unspecialized word is certainly critical, it is the common acceptation of the word in the context in which it appears that is determinative." As noted, the phrase on which Petitioners rely—"teacher"—appears in the following context:

> "The term does not include: . . . (2) a lawyer, accountant, engineer, teacher, or geologist whose performance of the services is solely incidental to the practice of the person's profession;"

TSA 581-4(N). The context in which the term " teacher" appears involves four other recognized professions, and in fact employs the phrase, "practice of the person's profession," all of which shows the legislative intent that a person falling within this exception must have at least an established and recognized profession within one of these indicated categories, and that the investment adviser services be *solely incidental* to the practice of the regular profession indicated. Thus the context in which the word "teacher" appears cannot plausibly have the simplified meaning ascribed by Petitioners—i.e., one who teaches. As the Fifth Circuit correctly noted, the

definition proposed by S&D "is circular and imprecise. It makes a teacher anyone who teaches." *S&D Trading Acad.*, 2009 WL 1885881 at *6. Such a tautology would render the statute both circular and essentially meaningless, and § 311.023(5) allows an interpreting court to take into consideration the consequences of a particular construction.

More fundamentally, however, TSA art. 581-10-1(A) declares that the TSA is to be "construed and implemented to effectuate its general purpose to maximize coordination with federal and other states' law and administration particularly with respect to: . . . (2) exemptions." This mandate must be taken into account when the TSA's terms are interpreted, according to TGC § 311.023(1) (instructing that in construing a code provision the object sought to be obtained is to be considered). Additionally, this mandate to "maximize coordination" with federal authorities, has been judicially recognized: "Texas courts generally look to decisions of the federal courts to interpret the Texas Securities Act because of the obvious similarities between the state and federal laws." *Akin v. Q-L Invs., Inc.*, 959 F.2d 521, 532 (5th Cir. 1992). As the Fifth Circuit in this case noted, the Texas Supreme Court has explained that the Texas Legislature intended the TSA "to be interpreted in harmony with federal securities law." *S&D Trading Acad.*, 2009 WL 1885881 at *4 (citing *Sterling Trust Co. v. Adderley*, 168 S.W.3d 835, 840 (Tex. 2005)).

The provisions of the IAA and TSA defining investment advisers are virtually indistinguishable, but the "teacher" exemption found in both is not just similar

—it is virtually identical. The IAA exemption is quoted below, with TSA variations noted in brackets:

> "(B) [a]ny lawyer, accountant, engineer, [or] teacher, [or geologist] whose performance of such [the] services is solely incidental to the practice of his [the person's] profession;"

15 U.S.C. § 80b-2(11). The only substantive difference is that the TSA includes "geologists."[5] As a result of the fact that these provisions are virtually identical, relying upon federal authority is consistent with the intention of the Texas State Legislature and the interpretive cannons of the Texas Code Construction Act, even were it applicable.

The IAA's legislative history indicates that it was understood that the Securities and Exchange Commission ("SEC") was to determine the scope of the definition of "investment adviser."[6] Furthermore, the Fifth Circuit was correct in noting that, given the absence of any Texas or federal cases which interpreted this exemption, a court could refer to no-action letters

---

[5] TSA art. 581-4(A) includes in its definition of the term security, "any instrument representing an interest in or under an oil, gas, or mining lease, fee or title . . ." As such, an exemption for a geologist who might recommend the purchase of oil and gas leases as a part of his or her profession is appropriate given Texas' extensive oil and gas industry.

[6] *Investment Trusts and Investment Companies: Hearings on H.R. 10065 before a Subcomm. of the H. Comm. on Interstate and Foreign Commerce*, 76 Cong. 90 (1940) (Statement of James White).

issued by the SEC as "persuasive authority" regarding the proper interpretation of a federal statute. *S&D Trading Acad.*, 2009 WL 1885881 at *4 (*citing Allaire Corp. v. Okumus*, 433 F.3d 248, 254 (2d Cir. 2006)).

The SEC, through its no-action letter program, has enunciated what practically has become a four-part test to determine whether or not someone qualifies for the "teacher" exemption, focusing on: who, where, what, and what for. All four of these prongs must be satisfied. The "who" focuses on whether the person claiming the exemption is in fact a genuine teacher practicing a teaching profession. The SEC's position is that for the exemption to apply the person proclaiming himself or herself a "teacher" entitled to rely on the exemption must in fact be "a teacher practicing his or her profession." *See J. H. Rodgas, Jr., SEC No-Action Letter*, 1974 WL 10941 at *1 (Sept. 7, 1974); *see also Walter H. Shapiro, SEC No-Action Letter*, 1978 WL 11703 at *2 (July 26, 1978) (explaining that a teacher means a "member of the teaching profession"). The SEC's interpretive guidelines require that a teacher must be actually teaching as a part of his or her regular profession. Furthermore, dispensation of any investment advice must be "solely incidental" to the professional services of a teacher. The guidelines, for example, do "not encompass a teacher who has established a separate investment advisory business." *See DJZ Associates, SEC No-Action Letter*, 1975 WL 9167 at *1 (September 26, 1975).

The "where" focuses on whether these teaching activities are conducted at an actual academic institute. In this regard, the SEC asks if the proposed "school"

has the attributes normally associated with an educational institute of higher learning and, to avoid artifice, focuses on whether the school is accredited by a state or federal agency.[7] *See, e.g., Joseph P. Canouse, Esq., SEC No-Action Letter*, 1977 WL 10657 at *1 (July 15, 1977). *See also, Rodgas*, 1974 WL 10941 at *4.

The "what" focuses on the nature of the information being "taught", namely whether it is a dispensation of general market information, or a specific curriculum designed to increase profits and profitability of a trader. The SEC inquires whether or not the curriculum being pursued is being offered as an "educational experience" versus merely for the purpose of influencing investment decision-making and assisting participants in maximizing profits from their investments. *See, e.g., David A. Umstead, SEC No-Action Letter*, 1976 WL 12176 at *1 (Aug. 13, 1976).

The "what for" focuses on the compensation received, and asks whether the teacher is compensated by means of a regular salary from his or her institution, and whether the students are charged a traditional tuition or something else. For example, the SEC inquires whether the "teacher" is paid a salary by an educational institution for whom he or she is employed. *See Canouse*, 1977 WL 10657 at *1. If the "teacher" is compensated separate from and in addition to his or her usual teaching salary, this is unacceptable. *See Umstead*, 1976 WL 12176 at *2.

[7] The activities must be as a part of an institute of higher learning, as teaching investment activities at a high school is hardly the norm.

The case at hand involves two day-traders working out of an apartment complex for fourteen months advising people about buying and selling specific stocks, at specific times, and imparting other trading strategies to be applied in the specific context of actual, live trading. Moreover, these advisers were charging $1 per thousand shares traded by each trader, as well as a percentage of profits made by the persons whom they were advising, all while they were themselves trading their own accounts. This conduct cannot be compared to a professor teaching at an accredited educational institution imparting generalized, non-specific marketing information for a salary. The Fifth Circuit correctly held: "Applying the teacher exception under these circumstances would allow almost any investment adviser to qualify for the exception so long as they accompanied their advice with a justifying explanation. This result would undermine the general purpose of the Texas Securities Act, which is 'to protect investors.'" *S&D Trading Acad.*, 2009 WL 1885881 at *6.

II. Even If The Texas State "Teacher" Exemption Were Available Petitioners Would Be Afforded No Relief

A. All Petitioners' Claims Fail As A Matter Of Law Because If There Is An Exemption For TSA Investment Adviser Registration, Then Petitioners Were Required To Register Under The IAA And Failed To Do So.

As noted above, the IAA defines "investment adviser" to include "any person who, for compensation, engages in the business of advising others, either

directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities. . . ." 15 U.S.C. § 80b-2(11). Petitioners implicitly concede that their activities fall within this definition. Even if the federal authorities referenced above regarding the "teacher" exemption were disregarded in the interpretation of the TSA, there is no basis for disregarding them in the context of the IAA.

Recognizing this, to find an exemption for registration under the IAA, Petitioners instead rely on 15 U.S.C. § 80b-3a(a) which exempts from federal registration an investment adviser who has assets under management of less than $25 million. This exemption, however, is only available if the investment adviser is "regulated or required to be regulated as an investment adviser in the State in which it maintains its principal office and place of business. . . ." 15 U.S.C. § 80b-3a(a). As Petitioners have their principal place of business in Texas, if Petitioners can rely on the "teacher" exemption in TSA art. 581-4(N)(2) to avoid registering under the TSA, then they are not "regulated or required to be regulated as an investment adviser" in Texas, and the exemption from federal registration in 15 U.S.C. § 80b-3a(a) is unavailable to them. Therefore in successfully establishing their exemption from registration under the TSA, Petitioners equally establish their obligation to effect federal registration—which they did not accomplish.

B. Additionally, All Petitioners' Claims Fail As A Matter Of Law Because They Were Required To Register As "Dealers" Under The TSA And Failed To Do So.

TSA art. 581-4(C) defines "dealer" even more broadly than the Exchange Act defines a "broker":

> The term "dealer" shall include every person or company other than an agent, who engages in this state, either for all or part of his or its time, directly or through an agent, in selling, offering for sale or delivery or soliciting subscriptions to or orders for, or undertaking to dispose of, or to invite offers for any security or securities and every person or company who deals in any other manner in any security or securities within this state.

TSA art. 581-4(C). Further, the TSA's definition of "sale," "offer for sale," and "sell" include even *attempts* to dispose of securities and also include "any act" by which purchases or sales are made including solicitations of a sale, solicitations of a purchase, and even attempts to sell or offers to sell. TSA art. 581-4(E). Thus, anyone who sells or offers for sale securities, or solicits orders for offers for sales of securities, or even invites offers for sales of securities, is a "dealer." To emphasize the breadth of coverage, the TSA also includes a catch-all phrase that brings within the definition of "dealer" every person or company who deals in any other manner in any security or securities within this state. TSA art. 581-4(C). It is without dispute that the "teacher" exemption that is engrafted into the statutory definition of a Texas

"investment adviser" is irrelevant to the "dealer" analysis. TSA art. 581-12 prohibits "dealers" from conducting business without first registering, and TSA art. 581-33(K) renders void and unenforceable any contract entered into by an unregistered "dealer."

Under Texas law, even a single, isolated performance of an act requiring registration is sufficient for 581-33(K) to apply. For example, In *Breeding v. Anderson*, 254 S.W.2d 377 (Tex. 1953), plaintiffs brought suit to recover commissions earned in connection with the sale of oil and gas leases. Both presently and at the time of that decision, the term "security" under the TSA encompassed instruments representing interests in or under oil and gas leases. Therefore, plaintiffs sought compensation derived from the sale of securities. The defendant asserted, among other things, that plaintiffs' failure to register as "dealers" under the TSA was a complete defense, and the Texas Supreme Court agreed, holding that there was "no question" but that the transaction on which the plaintiffs sought to recover commissions fell within the TSA, "which prohibits recovery of a commission, or compensation for services rendered making sales of securities or real estate" unless the claimant was properly registered as a dealer. *Id.* at 379. The Texas Supreme Court rejected an "isolated transaction" exception, holding that even the performance for compensation of *one act* by a person, in connection with the procurement of a prospect for the sale or purchase of securities requires registration. *Id.* at 380. Accordingly, the Texas Supreme Court denied recovery for failure to register as a "dealer." Petitioners failed to discuss this authority in the district court and in the Fifth Circuit. It is an absolute bar to recovery,

even if Petitioners are successful in their "teacher" analysis with regard to the state investment adviser registration issue.

C. Additionally, All Petitioners' Claims Fail As A Matter Of Law Because They Were Required To Register As "Brokers" Under The Exchange Act And Failed To Do So.

Section 15(a)(1) of the Exchange Act, 15 U.S.C. § 78o(a)(1), makes it illegal for a "broker" to effect any transaction in, or to induce or attempt to induce the purchase or sale of any security, unless such broker is registered with the SEC. 15 U.S.C. § 78o(a)(1). A "broker" is any person engaged in the business of effecting transactions in securities for the account of others. 15 U.S.C. § 78c(a)(4). There is no requirement to prove scienter to establish a violation of this statute. *SEC v Montana*, 464 F. Supp. 2d 772, 785 (S.D. Ind. 2006). Section 29(b) of the Exchange Act makes any contract or arrangement entered in violation of the securities laws void and unenforceable. 15 U.S.C. § 78cc(b).

In this case, Petitioners' own testimony demonstrates "a certain regularity of participation in securities transactions at key points in the chain of distribution" for the numerous securities transactions involving the Chinese traders whose training is at issue, and this triggers the registration requirements of the Exchange Act. *Mass. Fin. Servs., Inc. v. SIPC*, 411 F. Supp 411, 415 (D. Mass.), *aff'd*, 545 F.2d 754 (1st Cir. 1976). Further, Petitioners bargained for and received "transaction-based compensation"—compensation that

is in any way, directly or indirectly, tied to the "size, value, or occurrence" of securities transactions[8]—for that training, including compensation based on the number of securities transactions made. "Transaction-based compensation" is "one of the hallmarks of being a broker-dealer." *Cornhusker Energy Lexington, LLC v. Prospect Street Ventures*, No. 8:04-CV-586, 2006 WL 2620985 at *6 (D. Neb. Sep. 12, 2006); *see also SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005); *SEC v. Martino*, 255 F. Supp. 2d 268, 283-84 (S.D.N.Y. 2003); *SEC v. Margolin*, No. 92-Civ-6307, 1992 WL 279735 at *5 (S.D.N.Y. Sep. 30, 1992).

Petitioners received "transaction-based compensation" tied to the number of stock trades made. Indeed, Petitioners' own evidence establishes that they billed AAFIS at the rate of $1.00 per thousand shares traded and that all their invoices were paid. The receipt of transaction-based compensation is the single most important indicator of being a "broker" because recipients of transaction-based compensation have a "salesman's stake" in encouraging securities transactions, regardless of their underlying investment value to investors. *See Herbruck, Alder & Co., SEC No-Action Letter*, 2002 WL 1290291 at *2 (June 4, 2002). Accordingly, the SEC has repeatedly held that the receipt of transaction-based compensation required registration as a "broker" even though the conduct of

[8] *See GlobalTec Solutions, LLP, SEC No-Action Letter*, 2005 WL 3695276 at *1 (Dec. 28, 2005). As noted above, in both the district court and the Fifth Circuit, Petitioner's not only did not dispute that they received transaction-based compensation, they essentially acknowledged it. *See* discussion *supra* at note 2.

the party in question was more remote and isolated than was Petitioners', and numerous no-action letters to this effect substantiate this point.[9]

For example, in *John R. Wirthlin, SEC No-Action Letter*, 1999 WL 34898 (Jan. 19, 1999), an unregistered person sought instruction from the SEC about the requirements for "broker" registration for a business where Wirthlin proposed to contact professionals (such as accountants and real estate brokers) who might have clients interested in exchanging their interests in real estate for registered securities. *Id.* at *1. Wirthlin proposed to contact only professionals and would have no direct contact with investors. Wirthlin disclosed that he would receive what the SEC termed "transaction-based compensation," as his fee would be based on the consummation of transactions that were the result of Wirthlin's introductions. *Id.* Consistent with its past pronouncements, the SEC took the position that even though Wirthlin was not meeting with any prospective purchasers or customers, he would nevertheless be soliciting them indirectly to make investments in securities through their advisers. *Id.* This required registration. *Id.* The SEC also specifically noted that Wirthlin would receive transaction-based compensation, "one of the hallmarks" of a broker-dealer. *Id.*

[9] Indeed, the SEC has taken the position that even if a registered person properly receives transaction-based compensation, if there is a formal or even an informal obligation to turn that compensation over to a third person, then that third person must also be registered as a "broker" as the third person would then be receiving transaction-based compensation. *See, e.g., First Global, Inc., SEC No-Action Letter*, 2001 WL 499080 at *1-3 (May 7, 2001).

Petitioners' argument here that they were not acting as brokers as that term is understood in the Exchange Act is at odds with the *Wirthlin* and other SEC No-Action Letters because the admitted activities of Petitioners were much closer to the "key points in the chain of distribution," which is determinative in deciding whether registration is required, than were the proposed activities of which were the subject of the *Wirthlin* SEC No-Action Letter.

In this case, the activities of Petitioners described above, together with their receipt of transaction-based compensation, was sufficient to bring Petitioners within the definition of "brokers" under the Exchange Act. Therefore, they were required to register with the SEC and did not do so. This, alone, would be an absolute bar to recovery, even if a court found the "teacher" exception to Texas state investment adviser registration applicable.

CONCLUSION

For these reasons, Respondent respectfully submits that the petition for a writ of certiorari should be denied.

Respectfully submitted,

BEN C. BROOCKS
JACKSON WALKER L.L.P.
100 Congress Avenue
Suite 1100
Austin, Texas 78701
Telephone: (512) 236-2000
FAX: (512) 236-2002

Attorney for Respondent